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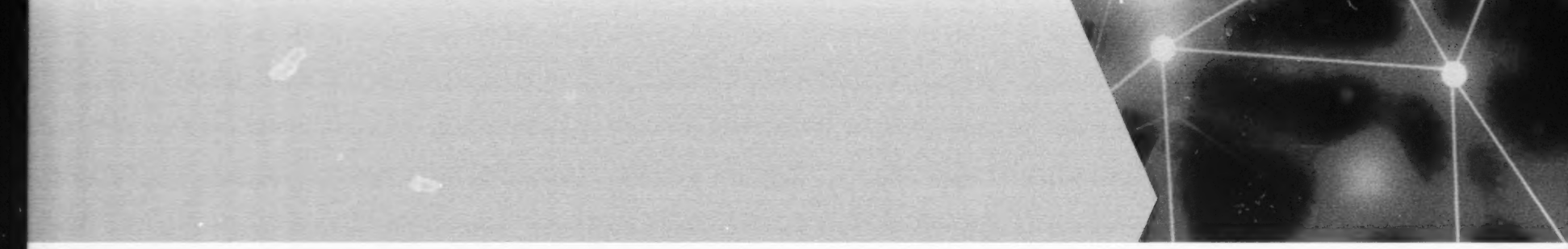
Canada's progress in FinTech:

Regulatory highlights following the Competition Bureau's Market Study

Canada



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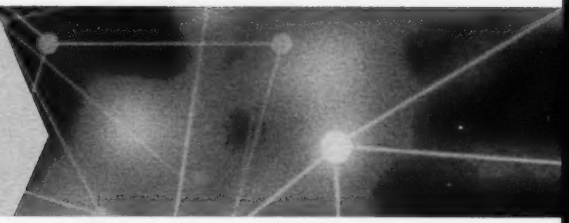
BACKGROUND



Technology-led innovation in the financial services sector (FinTech) is transforming what financial services are, and how they are delivered to consumers. Imagine comparing fund prices with a swipe of your smartphone, finding investors over an online platform and paying your bills in real-time. Imagine these tools in the palm of your hand no matter where you bank or invest. FinTech promises to "radically improve"[1] the way Canadians pay, save, borrow and invest by providing more flexible options that increase choice and convenience, improve quality and lower the prices of Canadian financial products and services.

But Canadians, relative to the United Kingdom, Australia and the United States, have lagged behind in FinTech adoption.[2] In 2016, the Competition Bureau (Bureau) launched a study to find out why. At the time, only 8.2% of Canadians used FinTech products, compared to 15.5% globally.[3] The Bureau's study aimed to provide concrete recommendations to Canada's regulators and policy makers on how to foster FinTech innovation and competition to the benefit of Canadian consumers and businesses alike.

In December 2017, after an extensive 18 month study of the industry, the Bureau published its Market Study Report (Report) and made 30 recommendations to Canada's regulators and policy makers. Nineteen recommendations identify specific, technical improvements for retail payments and payment systems; investment dealing and advice; and peer-to-peer lending and equity crowdfunding. Eleven recommendations focused more broadly on how to strike the right balance in regulation to ensure Canadians are protected while promoting innovation.

This Progress Report takes a look at these eleven recommendations and reviews how some recent regulatory and policy changes are helping Canada catch up to its international neighbours. It is clear that a real transformation is taking place, and the Bureau looks forward to seeing the greater evolution of the FinTech marketplace.

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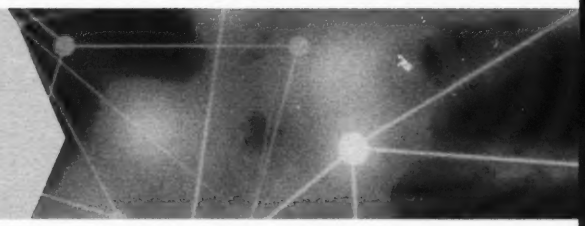
[1] Information Technology and Innovation Foundation, Policy Principles for Fintech (2016). See: http://www2.itif.org/2016-policy-principles-fintech.pdf?_ga=1.152446201.1360924339.1483633016

[2] Deloitte Consulting LLP, Closing the gap: Encouraging fintech innovation in Canada (2015). See: https://www2.deloitte.com/content/dam/Deloitte/ca/Documents/financial-services/CA-2017-FSI-EN-Closing-the-gap-AODA.PDF

[3] According the EY Adoption Index, Canada's adoption rate is just over half (18%) of the mean (33%) for those respondents who are "digitally active". Ernst & Young LLP, EY FinTech Adoption Index 2017 – Canadian Findings. See: https://www.ey.com/ca/en/industries/financial-services/ey-2017-fintech-adoption-index-canadian-findings

THE STUDY – BY THE NUMBERS



WHO DID WE TALK TO?

We spoke to 118 different stakeholders, including:

- 16 financial institutions
- 35 start-ups
- 26 Canadian federal and provincial agencies, regulators and rule-makers
- 9 foreign regulatory authorities
- 7 consumer advocate groups
- 25 others (e.g. industry associations, academics, technology firms)

POST-REPORT ADVOCACY

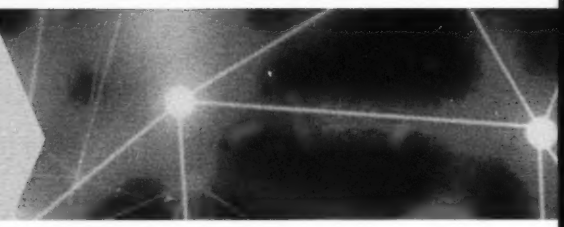
7 formal submissions to advise Canadian decision-makers on:

- The modernization of Canada's payments systems
- Proposed policy measures to position Canada's financial sector in the future
- The review of Canada's anti-money laundering and counter-terrorist activity financing legal framework
- The review of the Canadian Payments Act (CPA)
- British Columbia's Securities Law Framework

20 outreach events, policy labs and advocacy requests, including:

- National Crowdfunding Association Summit
- Canadian Bar Association's Competition Law Conferences
- Organisation for Economic Co-operation and Development workshop on regulation and competition in light of digitalisation
- 2018 Chatham House Competition Policy Conference
- Electronic Transaction Association Policy Day

RECENT DEVELOPMENTS



Recommendations by the Bureau	How this fosters competition and innovation	Where we see progress
1 REGULATION SHOULD BE TECHNOLOGY-NEUTRAL AND DEVICE-AGNOSTIC	Rules that can accommodate and encourage new and yet-to-be developed technologies pave the way for innovative products and services today and down the road.	Artificial intelligence and other innovations allow customers to have online interactive conversations that help them search for new products and services. Regulators and businesses can leverage these new technologies when it comes to gathering information. Using artificial intelligence is one way that businesses can gather information to advise customers and ensure regulatory compliance without the need for face-to-face interaction. In February 2018, the British Columbia Securities Commission's (BCSC) consultation on its Securities Law Framework for Fintech Regulation focused on a number of regulatory challenges. The Bureau's submission applauded the BCSC's consideration of automation to meet compliance obligations for "know-your-client"[4] assessments. This signals a shift away from relying on face-to-face conversations to ensure compliance and paves the way for automation and artificial intelligence to improve the quality and efficiency of investment advice, for example, through a broader variety of options at different prices that are tailored to each customer.

[4] Under securities law, investment dealers owe a duty of care to ensure any investments offered are suitable for a particular client. Suitability is typically determined by an advisor through conversations with clients to understand risk tolerance, investment objectives and investment time horizon. To meet the suitability requirement, an advisor must gather sufficient information on a client to the "Know-your-client" standard and also understand the products they are selling sufficiently to meet the "Know-your-product" standard.

Recommendations by the Bureau	How this fosters competition and innovation	Where we see progress
2 REGULATION SHOULD BE PRINCIPLES-BASED	Instead of prescribing exactly how a service must be carried out, a principles-based approach—e.g. best practices, guiding principles—will allow regulators to be more flexible and adapt their approach to enforcement as technology changes.	Regulators are changing the way they think about rules to avoid requirements that will be immediately outdated as a result of advancements in technology.[5] In May 2018, the Department of Finance Canada (Finance Canada) launched a consultation on the CPA. It builds on a proposed oversight regime that takes into account the specific risks associated with processing payments. In particular, the consultation highlights important oversight principles for the new "Real-Time Rail" (RTR), such as, requiring that any payment service provider holding customer funds overnight (or longer) must place those funds in a trust account with an institution protected by a deposit insurance regime. In this way, consumers can be assured that their funds are safe, regardless of how they make payment, whether by credit card, debit, e-transfer or mobile app. In the Bureau's submission to the consultation, it advised that Finance Canada's principles-based approach will ensure customers are covered and oversight can evolve as Canadians explore new ways to pay.
3 REGULATION SHOULD BE FUNCTION-BASED	Function-based regulation creates a level playing field for competition, by allowing all entities that perform the same function to carry the same regulatory burden. It also ensures that consumers (or any users) have the same protections when dealing with competing service providers.	The current financial sector regulatory framework is usually structured around who you are (entity-based) versus what you do (function-based). Finance Canada's Revised Anti-money laundering/counter-terrorist activity financing (AML/CT) regulations move toward a function-based approach. For example, no matter the entity, if the business "deals in virtual currencies,"[6] it must implement a full compliance program and register with Financial Transactions and Reports Analysis Centre of Canada (FINTRAC). This ensures the same compliance obligations for any business engaged in such activity. In February 2018, the Government of Canada (GoC) introduced amendments to the Bank Act (and related legislation) to allow trust companies, credit unions and co-operatives[7] to use words like "bank" and "banking" to promote their own products and services. The amendments also expanded the scope of technology-related activities banks can participate in so they are not as restricted simply by virtue of being banks. These changes provide greater flexibility for such firms to enter into new arrangements with third parties, such as FinTech firms.[8]

[5] As explained in depth in Payments Canada's *Modernization Target State* (2017), the Real-Time Rail is a real-time payment system that is "always on" (i.e. 24/7/254) to facilitate real-time delivery of low-value payments with funds immediately available to the recipient. Funds will be delivered in seconds. It will also enable the creation of overlay services—new service offerings that can be built atop the system's infrastructure—to serve as a platform for innovation.

[6] "Virtual currency is a medium of exchange that allows for value to be held and exchanged in an electronic, non-physical manner, is not a fiat currency (i.e. the official currency of a country), has the intended purpose of being exchanged for real and virtual goods and services, and allows peer-to-peer transfers." See: http://www.gazette.gc.ca/rp-pr/p1/2018/2018-06-09/html/reg1-eng.html

[7] There are instances where, particularly in the mind of a consumer, non-banks engage in activities that are similar to banking, such as holding deposits. Such firms may find it difficult to promote their services (and consumers may find it hard to compare service offerings) without the ability to use increasingly commonplace terms like "online banking". There will continue to be restrictions around how the term "bank" is used through, for example, requirements to disclose the type of entity and whether a firm is part of a deposit insurance scheme.

[8] A helpful summary of these and other amendments to financial services statutes further to Budget 2018 was published by McCarthy Tétrault (Badour, A., MacMullin, Marc .J., Ryan, Barry J.) on April 3, 2018. See: https://www.mccarthy.ca/en/insights/articles/budget-bill-2018-amendments-financial-services-statutes

Recommendations by the Bureau	How this fosters competition and innovation	Where we see progress
4 REGULATION SHOULD BE PROPORTIONAL TO RISK	Making regulation proportional to risk requires a tiered approach: functions whose failures pose lower risks to the financial system or its users should not necessarily face the same strict oversight as those whose failure poses higher risks. This will give smaller players a level playing field on which to compete and innovate.	Risk exists in every industry, and when it comes to financial products and services, consumers need to know that their money is safe and the industry is free from fraud and loss of privacy. But there is no one-size-fits-all solution. A failure when you are paying for coffee with your handheld is not the same as the failure of Canada's financial system. The rules should match the risk. In 2017, Finance Canada's consultation on a new retail payment oversight framework proposed a new set of rules focused on the payment process. From the moment a consumer taps their credit or debit card to the moment when the vendor receives the funds, there is a certain level of risk at each stage of the process. The new framework adapts its rules to match the level of risk at every stage.
5 REGULATORS SHOULD CONTINUE EFFORTS TO HARMONIZE ACROSS GEOGRAPHIC BOUNDARIES	Differences in regulations across provinces can lead to an increased compliance burden. Consistency can facilitate entry and expansion of FinTech across Canada and abroad.	Imagine you have a great idea and the know-how to start an online business that will help Canadians better manage their finances. Your home office is in Central Canada, but your employees and customers are across the country. How do you navigate the rules if they are different in every province? Provinces are working together to help address this regulatory fragmentation so businesses can easily cross provincial boundaries. For example, over the past year, Canada's securities regulators have been monitoring the evolution of virtual currency - in particular, its use as a means to raise business capital. In June 2018, the Canadian Securities Administrators (CSA) published additional guidance to harmonize how provincial securities rules may apply in this new FinTech space. Similarly, in 2018, the Ontario Securities Commission (OSC), the Financial Consumer Services Commission of New Brunswick, the CSA, the Investment Industry Regulatory Organization of Canada and the Mutual Fund Dealers Association, announced a harmonized response to conflicts of interest associated with embedded commissions and other third-party compensation as part of its "Client-Focussed Reforms" to promote the best interests of their clients.

Recommendations by the Bureau	How this fosters competition and innovation	Where we see progress
6 POLICY MAKERS SHOULD ENCOURAGE COLLABORATION	Greater collaboration will enable a clear and unified approach to risk, innovation and competition. Ways to collaborate include the use of regulatory sandboxes and innovation hubs.	Regulators are working together to create new regulatory ecosystems in Canada and abroad. They are reaching out to stakeholders, and more and more, speaking with one voice. Similarly, the provinces are collaborating and consulting across the country and the globe to learn from each other and find the right balance in their oversight of the industry. In August 2018, in collaboration with 11 financial regulators and organizations around the world[3], the OSC announced its participation in the Global Financial Innovation Network (GFIN). This collaboration aims to support firms who want to operate in multiple countries. The regulators in GFIN are also encouraging input from industry and the public through consultation. In December 2017, The CSA announced a new cooperation agreement with the Australian Securities and Investments Commission (ASIC) that brought together seven Canadian securities regulators to extend the CSA's Regulatory Sandbox and ASIC Innovation Hub which provide controlled environments for authorized businesses to test innovation. The goal is to support greater information sharing among participants and streamline the referral process for any business seeking entry into new markets.
7 POLICY MAKERS SHOULD IDENTIFY A FINTECH POLICY LEAD	A FinTech policy lead would give FinTech firms a one-stop resource for information and encourage greater investment in innovative businesses.	A common characteristic of successful FinTech hubs, in terms of talent, funding, government policy and consumer demand, is a unified approach to FinTech. It is easier to understand how to enter the market, when there's a one-stop shop for policy and information. Finance Canada and provincial regulators, in particular, have advanced a number of initiatives to support changes to Canada's financial regulatory framework, but there remains no clear policy lead in Canada.

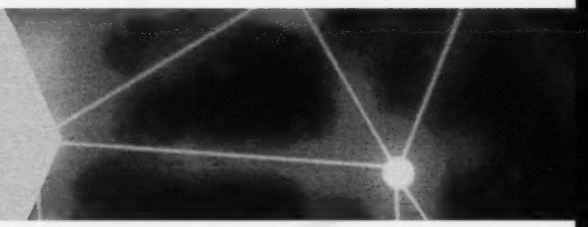
[3] Participant stakeholders and regulators include: Abu Dhabi Global Market Financial Services Regulatory Authority, l'Autorité des marchés financiers (Québec), the Australian Securities and Investments Commission, Central Bank of Bahrain, Bureau of Consumer Financial Protection (US), Dubai Financial Services Authority, Financial Conduct Authority (UK), Guernsey Financial Services Commission, Hong Kong Monetary Authority, Monetary Authority of Singapore, OSC, and the Consultative Group to Assist the Poor (World Bank).

Recommendations by the Bureau	How this fosters competition and innovation	Where we see progress
8 REGULATORS SHOULD PROMOTE GREATER ACCESS TO CORE INFRASTRUCTURE AND SERVICES	The current regulatory framework for retail payments presents a barrier to entry for many new "non-bank" firms owing to various factors, including membership criteria and competitive dynamics. Greater access to the payments system (under the appropriate risk-management framework) and banking services would allow these firms to compete with current service providers and facilitate the development of new FinTech services.	In the financial sector, some competitors have direct access to the system that moves your money from one account to another. Regulators are making access to this behind-the-scenes payment infrastructure more accessible to new business models, removing a significant barrier to entry for new innovators to enter and compete. Finance Canada's 2018 consultation on the CPA proposed broader, risk-based access to the RTR through the creation of a new membership class that would allow new (eligible) participants to use the RTR and develop new overlay products and services such as budget tracking apps. The Bureau's submission cautioned that while broader access is desirable, having distinct categories can create new barriers and reduce incentives for new entrants to grow. The Bureau recommended the broadest levels of access to payments infrastructure in order to encourage competition between new entrants, incumbents and future providers. This recommendation built on the Bureau's December 2017 submission to Payments Canada's consultation on payments modernization. In the latter submission, the Bureau emphasized the importance of open access models for modernization because lack of access is the largest barrier to entry in retail payments. In 2018, Finance Canada launched consultations on Canada's AML/CT regime, and in particular, on the practice of "de-risking". Banks can terminate, or refuse to provide, banking services to clients who use payment or money transfer services in order to minimize their own risk of non-compliance. This gives banks (and similar institutions) the unique ability to potentially foreclose entry of new competition. In its submission, the Bureau recommended that an evidence-based reason be required when account services are refused or terminated and that there be suitable recourse available for clients.
9 POLICY MAKERS SHOULD EMBRACE "OPEN ACCESS"	With better access to consumer data (obtained through informed consent), FinTech can help Canadians overcome an inability or unwillingness to shop around and switch between service providers.	New applications to compare products, organize your bills and estimate your household budget are becoming available every day. To use them, you need to be able to share your financial data. With the right regulatory framework, one that protects you and your data, the choice of how and with whom your financial data is shared could literally be in your hands. In Budget 2018, the GoC committed to study the merits of an open banking regime in Canada to give Canadians access to their banking data and enable customers to access competitive and innovative tailored products and services. It will be important to keep an eye on the progress of the United Kingdom and Australia's open banking implementation to inform Canada's approach.

Recommendations by the Bureau	How this fosters competition and innovation	Where we see progress
10 INDUSTRY PARTICIPANTS AND REGULATORS SHOULD EXPLORE THE POTENTIAL OF DIGITAL IDENTIFICATION	Digital identification would reduce the costs of on-boarding new customers for service providers, ultimately reducing the costs of switching for consumers and making regulatory compliance easier when identity verification is needed.	Imagine that access to new financial products and services was as easy as a swipe of a screen, and switching banking providers was as simple as a mouse click. No more walking into a storefront merely to prove who you are. The Revised AML/CT regulations, referenced in recommendation 3, repealed the prohibition on the use of scanned or photocopied documents and allowed for an "authentic, valid and current" document. The proposed amendments would also allow firms that must report to FINTRAC under the AML/CT regime to rely on identification performed by third-parties, paving the way for new digital authentication services. As well, the amendments to the Bank Act (referenced in recommendation 3) will expand the scope of services that "banks" and similar institutions can provide to include identification, authentication and verification services.
11 POLICY MAKERS SHOULD CONTINUE TO REVIEW THEIR REGULATORY FRAMEWORKS FREQUENTLY	Regular reviews ensure that the rules adapt to change by achieving their objectives (e.g. privacy, consumer protection, security of the financial system) in a way that leaves room for competition and its benefits: lower prices, greater choice, higher quality products, and innovation.	In an era of continuous and dynamic change, regulatory leaders now have an exciting opportunity to demonstrate adaptability in how they design and enforce rules as they become the "regulator of tomorrow."[10] Particularly in the last year, Canada's financial regulatory regimes have been under review at both the federal and provincial level. In addition to its review of Canada's AML/CT regime, Finance Canada launched its review of the CPA, which aligns with Payment Canada's multi-year payments modernization project. This builds on Finance Canada's previous consultations on a new retail payments oversight framework, and potential policy measures to update Canada's federal financial sector legislative framework. The Bureau provided submissions to each of these reviews, most recently applauding Finance Canada's comprehensive review and highlighting the importance of regular reviews to ensure that innovation is supported in an increasingly dynamic environment. Ontario's Red Tape Challenge: Financial services report utilized public consultations over the course of 2017 to highlight 51 opportunities to modernize regulations in the financial services sector.

[10] Deloitte Consulting LLP, Regulator of Tomorrow: Rulemaking and enforcement in an era of exponential change (2015). See: https://www2.deloitte.com/content/dam/Deloitte/tr/Documents/public-sector/Regulator-of-tomorrow_vFINAL.pdf

CONCLUSION



Last year, 76% of Canadians owned a smartphone. Whether they viewed the device as a nuisance or a third arm, smartphones have connected the world in ways never before thought possible. This level of functionality and convenience paves the way for innovation in the financial services sector and opens new doors for countries to tap into their FinTech potential.

By starting a national conversation with financial institutions, start-ups, partners in Government, rule-makers, advocacy groups and industry, the Bureau produced its Report, Technology-led Innovation in the Canadian financial services sector. The recommendations within this report sought to find a balance between protecting Canadian consumers and promoting the same type of Canadian ingenuity that first brought us the telephone. To do so, they seek to offer concrete advice on how to build a regulatory frame that adapts and strengthens Canada's already strong financial system and reputation.

Since the Report was published, the Bureau has continued to advance the national and international dialogue on the future of FinTech through advocacy and outreach. By remaining a part of this conversation, Canada is better positioned to adapt, and learn from our own subject-matter experts as well as our international neighbours.

The popularity of FinTech will continue to grow in the future, and Canada must keep pace in order to be competitive in the global market. Some key developments to watch for are:

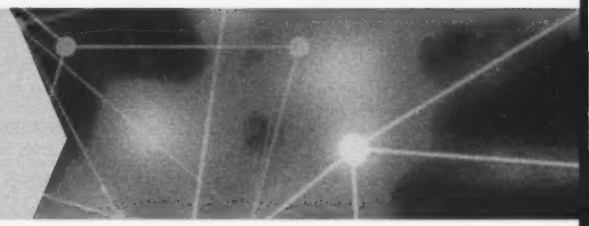
- The future of Canada's payment systems and open banking is expected to take shape. In Canada, we have the unique opportunity to learn from our peers who have recently introduced their own models to craft one that works for Canadian consumers and businesses.
- Everyone is talking about Big Data and it is more than just a buzz word. Alongside open banking, how Canada's National Digital and Data Consultations evolve may impact the competitive landscape with technology firms looking to enter the financial sector and capitalize on the customer data they possess (and traditional financial firms looking to expand beyond financial services for the same reasons).

- Ontario announced a FinTech Accelerator Office that will connect start-ups to businesses and provide support designed to grow the province's financial technology sector. It is important to keep an eye on the success of such initiatives and position ourselves to exploit and deploy homegrown best practices across the country.
- New rules will continue to emerge, for example, the CSA's proposal "to prohibit the payment of trailing commissions to dealers who do not make a suitability assessment."
- Government and regulators have advanced a number of initiatives to support competition and innovation in Canada's financial regulatory framework but a dedicated policy lead has yet to be identified. It will be important to compare our progress against that of other countries that have appointed a dedicated lead to determine the next steps for Canada.

The financial services sector impacts the lives of Canadians every day. The ability to communicate and have access to data in real-time is beyond science fiction and part of the day-to-day reality of Canadians. The Bureau saw an opportunity to promote innovation in Canada by making smart recommendations on how to regulate and tap into Canada's FinTech potential.

Since 2016, real change has taken place. Canada has worked hard to catch up to its international neighbours, and it is important that Canada's regulators and policy makers continue building on this momentum. But there is more work to be done. In particular, the Bureau will be watching the Government's commitment to examine open banking and modernize the financial sector framework. The technology that made FinTech possible has not finished evolving, so the Bureau will be keeping an eye on developments and be ready to bring the competition lens into focus for Canadians.

ABBREVIATION SHORTHAND



AML/CT	Anti-money laundering/counter-terrorist activity financing
ASIC	Australian Securities and Investments Commission
BCSC	British Columbia Securities Commission
CPA	Canadian Payments Act
CSA	Canadian Securities Administrators
FINTRAC	Financial Transactions and Reports Analysis Centre of Canada
GFIN	Global FinTech Innovation Network
GoC	Government of Canada
OSC	Ontario Securities Commission
RTR	Real-Time Rail